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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

No. 453

COMMERCIAL DISCOUNT COMPANY,

Petitioner,

vs.

ETHEL STRICKLAND ROGAN, Executrix of the Last Will and Testament of Nat Rogan, Deceased,

Respondent.

Petition for Writ of Certiorari to the Circuit Court of Appeals for the Ninth Circuit, and Brief in Support Thereof.

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Respondent.

Petition for Writ of Certiorari to the Circuit Court of Appeals for the Ninth Circuit.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

COMMERCIAL DISCOUNT COMPANY, a corporation, respectfully petitions that a writ of certiorari issue to review the final judgment of the Circuit Court of Appeals for the Ninth Circuit in that certain cause therein entitled "Ethel Strickland Rogan, Executrix of the last will and testament of Nat Rogan, Deceased, Appellant, vs. Commercial Discount Company, Appellee," being

therein number 10,844. Said judgment was entered by said Circuit Court of Appeals on May 25, 1945 [R. 145]. A petition for rehearing was filed by Commercial Discount Company within the time allowed therefor by rule of court, and an order denying said petition for rehearing was filed on June 29, 1945 [R. 146].

Opinion Below.

The opinion of the Circuit Court of Appeals for the Ninth Circuit in this cause is set forth in full at R. 131.

Jurisdiction.

The jurisdiction of this court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A. §347(a)).

This petition is made pursuant to Paragraph 5(b) of Rule 38 of the Rules of this court, and in particular the part thereof which suggests that a writ of certiorari may be issued where a Circuit Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this court.

The cause sought to be reviewed herein involves the decision of an important question of national importance concerning the proper construction and application of the Internal Revenue Code and in particular the authority of the Commissioner of Internal Revenue to deny to a taxpayer using the reserve method for treatment of bad debts the right to claim the deduction permitted by the Code and thus to pay taxes only on net income.

Questions Presented.

1. May a taxpayer who has established the reserve method for treating bad debts deduct from gross income a reasonable addition to such reserve account "only to the extent of the amount of the debts which have been ascertained to be wholly or partially worthless and charged against the account during the taxable year"[1]?

2. Must a taxpayer using the reserve method for treating bad debts, as a prerequisite to the right to deduct additions to the reserve, comply with that portion of Section 23(k)[2] of the Revenue Act of 1934 which requires ascertainment of worthlessness and charge-off during the taxable year?

3. Does Art. 23(k)[3] of Treasury Regulations 86 (promulgated under the Revenue Act of 1934) require that a taxpayer using the reserve method of treating bad debts must, as a prerequisite to deducting additions to the reserve, ascertain worthlessness and charge-off within the taxable year?

4. May a taxpayer who has established the reserve method for treating bad debts be denied the rights granted to taxpayers generally by Section 322(a)(1) of the Internal Revenue Code to recover, through claim for refund, taxes paid through inadvertence or mistake?

5. Is a taxpayer who has established the reserve method for treatment of bad debts entitled, through a claim for refund, to recover taxes overpaid where the overpayment was due to an erroneous under-statement of the amount reasonably needed in the reserve account?

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[1]As stated by the Circuit Court of Appeals [R. 138].
[2]Quoted on page 12 of Supporting Brief.
[3]See Appendix, pages 29-31.

Summary Statement of Matter Involved.

Petitioner, Comercial Discount Company, a California corporation, prior to March 15, 1938, executed and filed with respondent a claim for refund of federal income taxes paid for the year 1934 [R. 7, 8, 12, 42]. Thereafter, said claim was disallowed [R. 7, 42] and, following notice of such disallowance, petitioner filed this action. The trial court gave judgment for petitioner [R. 45] and, upon appeal by respondent, the Circuit Court of Appeals reversed [R. 145].

Only the following facts involved in this proceeding need be stated to raise the issues that petitioner calls to the attention of this court:

Petitioner's principal business since prior to the year 1934 has been the purchase of contracts for the conditional sale of automobiles and the collection of payments falling due under such contracts [R. 5, 23]. Petitioner has since prior to the year 1934 followed the practice of deducting from income, on its income tax returns, additions to a reserve account for bad debts, rather than deducting specific bad debts ascertained to be worthless [R. 59].

On or about May 15, 1934, the Hollywood Improvement Co. was indebted to petitioner in the amount of $194,513.94 [R. 4, 40]. According to the terms of the promissory note evidencing the indebtedness, the Improvement Co. was not to be personally liable on said note or for any deficiency following sale under or foreclosure of the deed of trust securing the same [R. 3, 40].

Default having occurred under the terms of the promissory note and the deed of trust, petitioner entered into

negotiations with the Improvement Co. for the acquisition of title to the property covered by the deed of trust by means of a voluntary deed in lieu of proceedings for trustee's sale or foreclosure, and on or about May 15, 1934 such conveyance was made in satisfaction of said indebtedness [R. 4, 40].

The property so received had a value on that date of $70,000 [R. 105] and petitoner then and there suffered an actual loss of $124,513.94 [R. 4, 40]. Such loss was one outside the usual and ordinary course of petitioner's business [R. 41].

For the year 1934 petitioner made on its books, and deducted from gross income on its federal income tax return, an addition to its reserve for bad debts in the aggregate amount of $49,595.44 [R. 41, 81]. In determining the amount of said addition to bad debt reserve for such year, petitioner did not take into consideration and did not make any allowance for said loss of $124,513.94 [R. 41, 81-82] for the reason that petitioner did not at that time construe the transaction as one giving rise to a bad debt loss, and improperly analyzed it for tax purposes as a purchase of the property [R. 41, 70-71].

Petitioner has never claimed in or in connection with its income tax liability for any year other than 1934, any deduction or allowance of said loss [R. 41-42, 82].

The trial court found that at the end of the year 1934 petitioner knew that said indebtedness no longer existed, and that the amount by which the total indebtedness exceeded the market value of the property received in lieu of foreclosure could not be collected or recovered from the Hollywood Improvement Co. [R. 43]; that the sum of $49,595.44, plus the sum of $124,513.94, making a total

sum of $174,101.38, was a reasonable addition to petitioner's reserve account for bad debts which should have been made for the year 1934 [R. 41]; and gave judgment for petitioner [R. 45].

The Circuit Court of Appeals, in reversing the trial court, apparently held that those provisions of Section 23(k) of the Revenue Act of 1934, which expressly relate to taxpayers on the "charge-off" method of treating bad debts, apply likewise to taxpayers on the reserve method, and that since the petitioner failed during the taxable year to ascertain the *amount* of its loss and charge off or make appropriate entries on its books during the taxable year reflecting such loss, all rights to consider such loss in computing net income for such tax year were forever lost.

Specification of Errors.

The Circuit Court of Appeals erred:

1. In holding that the only amount that may be added to bad debt reserve is exactly the amount of bad debts ascertained to be worthless and charged off during the year; thus nullifying one of the alternative methods of treating bad debts authorized by the statute;

2. In applying to a taxpayer on the reserve method of treating bad debts, those portions of Section 23(k) of the Revenue Act of 1934 and of Treas-

ury Regulations 86, Article 23(k), which relate solely to taxpayers on the charge-off method;

3. In failing to distinguish inherent differences between the charge-off and reserve methods;

4. In failing to recognize that for taxpayers on the reserve method the authorized deduction from income is an addition to the reserve which may take into consideration, but is not exclusively measured by, specific bad debts;

5. In holding (if it did so hold) that petitioner was attempting, through a claim for refund, to deduct retroactively a specific bad debt;

6. In holding that petitioner by this action was seeking to obtain a deduction for a specific bad debt;

7. In failing to hold that the decisions of other courts determining the rights of taxpayers on the charge-off method necessarily apply principles foreign to the issues of the case at bar;

8. In holding that a taxpayer on the reserve method of treating bad debts must, as a condition to the taking of the authorized deduction, make book entries during the taxable year showing a credit to the reserve for bad debts;

9. In failing to hold that petitioner did not lose its right to the deduction merely because it failed to set up the same on its books or claim it at the time of filing its return.

Reasons for Granting the Writ.

1. The decision of the Circuit Court of Appeals, holding that a taxpayer on the reserve method loses all right to claim a deduction because of bad debts unless he ascertains their worthlessness and charges off the debt or makes other book entries thereon during the taxable year, involves an important question of federal law which has not been, but should be, settled by this Honorable Court.

It is believed that this question is a highly important one. It involves the proper construction of a federal statute governing the right of many taxpayers to claim deductions and to file claims for refund on account of bad debt losses. It is respectfully submitted that the Circuit Court of Appeals' decision constitutes a judicial repeal of Congressional grant to taxpayers of the right to use either one of two alternative methods of treating bad debts for income tax purposes; and that it further nullifies the right granted by Section 322(a)[4] of the Revenue Act of 1934 and subsequent acts to a taxpayer, through claim for refund, to correct errors and mistakes and to determine proper tax liability.

Our research has not disclosed any proceeding, prior to the instant one, in which this question has been squarely presented for decision either to the Circuit Court of Appeals or to this Honorable Court.

2. The decision of the Circuit Court of Appeals is contrary to the practice of the Commissioner, as is disclosed by the record in this proceeding [R. 98-103], and is contrary to the results reached by the Board of Tax

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[4]See Appendix, page 29.

Appeals in two decisions that have come to our attention, one of which was affirmed by the Circuit Court of Appeals.[5]

Petitioner respectfully represents that said questions properly appear in the record and were raised before the trial court and the Circuit Court of Appeals.

Wherefore, your petitioner respectfully prays that a Writ of Certiorari issue out of and under the Seal of this Honorable Court directed to the Circuit Court of Appeals for the Ninth Circuit, requiring said court to certify and send to this court a full and complete transcript of the record and of the proceedings in said Circuit Court of Appeals in the case therein numbered 10,844, and entitled "Ethel Strickland Rogan, Executrix of the last will and testament of Nat Rogan, Deceased, Appellant, vs. Commercial Discount Company, Appellee," to be reviewed and determined by this Honorable Court, as provided by law; that the judgment of said Circuit Court of Appeals herein be reversed by this Honorable Court; and for such further relief as to this Court may seem proper.

Dated: September 21, 1945.

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[5]See footnote 8, p. 24, of Supporting Brief.